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SUBJECT: Canadian Capital Markets Update - Free Trade in Securities
and Toronto Montreal Exchange Merger

REF: (A) 07 Toronto 375 (notal) (B) 07 Toronto 160 (notal)
(C) 07 Toronto 372 (notal)

Sensitive But Unclassified -- protect accordingly.

11. (SBU) SUMMARY: Canadian market and regulatory officials applaud U.S. Securities and Exchange Commission (SEC) deliberations to allow U.S. investors to trade directly on foreign exchanges that have regulations in line with U.S. securities regulations. Free trade in securities has been a priority issue under the Security and Prosperity Partnership (SPP). Canadian market analysts believe mutual recognition of securities regulations would enable U.S. investors to directly access the Canadian market and would encourage foreign issuers to list on the Toronto Stock Exchange (TSX), the world's seventh largest exchange by market capitalization (almost US\$2 trillion). Market watchers are optimistic that the proposed merger of the TSX and the Montreal Exchange (MX) will increase cooperation among Canadian regulatory jurisdictions, effectively moving Canada closer to a common domestic securities regulation. The TSX/MX merger seems on track and awaits approvals from TSX and MX shareholders, Ontario and Quebec regulators, the Canadian Competition Bureau, and the SEC. Canadian securities regulators are highly motivated and would make good partners for the SEC to ensure a successful transition to mutual recognition of securities regulation across the US/Canada border. END SUMMARY.

Mutual Recognition in Securities

12. (SBU) More than a dozen large U.S. brokerages, such as Merrill Lynch, currently allow U.S. investors to buy Canadian stocks through a Canadian office or partner, but existing cross-border investment rules are a costly barrier for small investors and securities firms. Canadians were pleased that the SEC is considering changing its approach to regulating U.S. investors' trading on foreign stock exchanges in order to keep pace with U.S. investors who are increasing their international investments as the U.S. dollar falls. Converging international accounting standards and securities regulation principles, and closer ties among exchanges in different countries, may have made the concept of mutual recognition more palatable to regulators. The NYSE's purchase of Euronext last year to form NYSE Euronext Inc would be another beneficiary if U.S. investors can more easily trade international securities. Canadian officials realize that as yet no date has been set for commission consideration of the proposed rule change, which SEC Chairman Cox

previewed in a December 19th speech at Columbia University.

13. (SBU) Canadian analysts believe the TSX would win mutual recognition approval from the SEC under the new rules, though investor demand for quick access to European markets and concerns about dealing with Canada's multiple securities regulators could put Canada farther down the list for mutual recognition by the SEC than some other regulatory jurisdictions. If the rules change, the TSX expects to gain more U.S. investors, which would increase the exchange's trading volumes and fee revenue. Mutual recognition could also make it easier to persuade global companies (especially in the commodities sector) to list shares on the TSX. Mutual recognition of securities regulations also could help Canadian "snowbird" investors who winter in the U.S. to avoid technical violations of U.S. securities laws when they trade Canadian-listed securities while residing in the U.S.

TSX -- MX Merger

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14. (SBU) Market watchers are optimistic that the proposed merger between the TSX and the Montreal Exchange (MX), Canada's leading derivatives exchange (ref (B)), will be approved, creating a new Toronto-based market entity called the "TMX Group." A TSX contact told us that the announced February departure of TSX CEO Richard Nesbitt will not slow the deal. Under the terms of the C\$1.3 billion deal, the TSX Group will indirectly acquire all of the MX's outstanding common shares. On November 29, the TSX Group was valued at around C\$3.5 billion and Montreal Exchange Inc. was valued at about C\$1.1 billion on the TSX. The Ontario Securities Commission (OSC) will oversee the new Toronto-based TMX entity, while the derivatives piece of the business, still based in Montreal, will be overseen by Quebec's Autorit  des march s financiers (AMF).

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15. (SBU) Financial sector analysts reportedly see Nesbitt's departure as opening the way for Luc Bertrand, the Ontario-born francophone head of the MX, currently slated to be deputy of the combined exchange, to instead be named CEO. Analysts speculate that naming Bertrand to the CEO job might also allay Quebec political concerns about the deal. Bertrand's previous experience with the Boston Options Exchange could also help the combined exchange expand its business south of the border. The TSX/MX merger still requires approvals from TSX shareholders; a quorum of MX shareholders (a special MX shareholder meeting is scheduled for mid-February); the OSC; the AMF, which plans to hold two days of hearings in late February or early March; the Canadian federal Competition Bureau; and the SEC.

Single Securities Regulator Update

16. (SBU) Critics point to Canada's fragmented capital regulatory system, separated by provincial and territorial boundaries (ref (B)), as a continuing barrier to "free trade" in securities, and European, Canadian, and U.S. media have speculated that European jurisdictions may receive SEC mutual recognition approval before Canada does. An OSC contact explained to us that the mutual recognition initiative, while led by Ontario in partnership with Quebec, is actually a Canadian Securities Administrators (CSA) initiative. The contact said the 13 provincial and territorial members of the CSA ((ref (B))) are very supportive of the efforts needed to position Canada for mutual recognition. The consolidation of the Canadian market through the TSX/MX merger is expected to increase cooperation between Canadian regulatory jurisdictions, which the OSC believes may move Canada closer to common securities regulation (reftels).

17. (SBU) COMMENT: Our OSC contact said OSC believes the SEC is likely to test the waters first with jurisdictions whose regulatory

structure are most comparable to the United States. Given the sectoral niche markets of North America -- large caps on the NYSE, tech stocks on the NASDAQ, energy and mining stocks on the TSX, and small-micro caps on the TSX Venture Exchange in Calgary - some here believe it would make sense to "streamline" North American markets by easing cross-border securities trading before focusing on Europe.

Canadian market operators and regulators recognize the value of easing cross-border securities trade restrictions and hope Canada will be one of the initial jurisdictions slated for mutual recognition, although they recognize that the SEC has offered no details as to timing or likely market priority when it actually moves to ease the rules regarding U.S. trades on foreign exchanges. Canadian securities regulators are highly motivated and would make good partners for the SEC to ensure a successful transition to mutual recognition of securities regulation across the U.S.-Canada border. END COMMENT.

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